Research Update:

3i Group PLC Affirmed At 'BBB+/A-2'; Outlook Stable; New Debt Rated 'BBB+'

May 31, 2023

Overview

- U.K.-based 3i Group PLC (3i) is issuing a €500 million senior unsecured note, due 2029, and will use the proceeds for general corporate purposes and to fund future acquisitions.
- We affirmed our 'BBB+/A-2' long- and short-term issuer credit ratings on 3i Group and assigned our 'BBB+' issue rating to the proposed instrument, subject to the review of the final terms and conditions.
- The stable outlook on 3i reflects our expectation that, over the medium term, it will maintain robust risk-adjusted leverage, even after the new bond issuance, and adequate liquidity.

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Rating Action

On May 31, 2023, S&P Global Ratings affirmed its 'BBB+/A-2' long- and short-term issuer credit ratings on 3i Group PLC (3i). The outlook remains stable. At the same time, we assigned our 'BBB+' issue rating to the proposed senior unsecured note and affirmed the 'BBB+' issue rating on 3i's existing term debt due 2032 and 2040.

Rationale

Post-issuance, we forecast 3i's stressed leverage will remain comfortably above 3.5x, indicating a very strong position. Since a £200 million note matured in March 2023, the new issuance would only increase total debt about £240 million compared to year-end 2022. Furthermore, at the end of fiscal year 2022, 3i's portfolio expanded 28.5% year on year to reach £18.4 billion, leading us to calculate stressed leverage above 6.0x, with our longstanding view of 3i's low leverage unchanged. Although the investment portfolio is fairly large compared with 3i's recourse liabilities, it is also composed of illiquid assets that could be difficult to fully realize in a timely fashion during a stress scenario. When calculating our stressed leverage ratio, we apply a 50% haircut on listed stocks (Basic-Fit and 3i Infrastructure PLC listed as quoted investments) and a 60% haircut on unlisted stocks, which is commensurate with a 'BBB' stress scenario.

Structural concentration risk in 3i's portfolio continues to weigh on the rating. In particular, its investment in European discount retailer Action (Peer Holding III B.V.; 'BB-/Stable/--'), represented a large 60.8% of the total portfolio at March 31, 2023, compared to 50.1% at March 31, 2022. Although we acknowledge the higher concentration is the result of Action's good performance and increasing valuation, we still consider it distorts our leverage metric in a stress scenario if 3i cannot, even partially, realize the assets to payback its recourse liabilities. Still, this high-risk exposure continues to prove its resilience through good times and bad. Action has continued to increase the number of retail stores and improve efficiency in 2022, with net sales up 29.6% to €8.9 billion and reported EBITDA up 45.5% to €1.2 billion. At March 31, 2023, Action's value increased 56.1% or £4.0 billion year on year, accounting for the majority of the investment portfolio's 28.5% increase on the same date.

3i's liquidity position remains adequate considering its higher dividend and announced carried interest payments. This balances the higher cash on its balance sheet and extension of its revolving credit facility (RCF) to £900 million from £500 million, with the announced dividend increase and carried interest payments. As income sources, we forecast dividend and interest income from its portfolio, to which we apply a 50% haircut, of approximately £425 million; other fee income of about £70 million; and cash of £852 million, which includes the £412 million in cash and cash equivalents on its balance sheet and proceeds from the proposed debt issuance of about £440 million. We also consider its stake in listed public equity Basic-Fit of £121 million post a 50% haircut. In relation to income uses, we expect 3i will use £250 million for carried interest payables following the sale of Havea and Action-related limited partner transactions, £511 million for distributions, and about £200 million for expenses. We also believe that in a slowdown, cash could be used to take advantage of opportunities in the market and support portfolio companies that have liquidity issues. We estimate £300 million-£500 million for such cases but acknowledge that any future investment would remain within 3i's capacity and not jeopardize any debt repayment. We calculate 3i's liquidity sources would cover its uses 1.5x, which is commensurate with an adequate liquidity assessment. We view positively 3i's strategy to leave its RCF undrawn as much as possible.

We assigned our 'BBB+' issue rating to the senior unsecured notes. The proposed note, maturing in 2029, will rank pari passu with the company's existing notes. At fiscal year-end 2023, 3i's term debt consisted of £375 million maturing in 2032 and £400 million maturing in 2040. We expect the new note to carry a more favorable interest rate than the 6.875%, £200 million note repaid in March 2023. We estimate that total gross debt will remain below £1.3 billion after the issuance. We do not notch down because the debt is not subordinated and since 3i does not hold any other secured debt. There are also no covenants on any of the previously mentioned lines or for the proposed debt.

Outlook

The stable outlook reflects our expectation that the group will preserve a conservative financial leverage policy and adequate liquidity levels, while managing concentration risks in the investment portfolio and maintaining solid operating and financial performances.

Downside scenario

We could lower the rating in the next 12-24 months if the quality and liquidity of 3i's concentrated investment portfolio deteriorate on the back of a protracted recession, contrary to our base-case scenario. In particular, we would lower our rating if 3i's asset valuations--including that of its largest exposure, retailer Action--deteriorate to the extent that they push the stressed leverage ratio sustainably below 3.5x. We could also lower our rating if 3i departs from its conservative leverage and liquidity policy, notably regarding acquisitions and investments.

Upside scenario

We could raise the rating if the company continues to increase its capital buffer, mitigating concentration concerns, while maintaining adequate liquidity.

Ratings Score Snapshot

Issuer Credit Rating	BBB+/Stable/A-2
Risk-adjusted leverage	Adequate
Stressed leverage	Very Strong
Risk position	Weak
Funding and liquidity	Adequate
Funding	Strong
Liquidity	Adequate
Preliminary anchor	bbb+
Jurisdictional risk	0
Anchor	bbb+
Modifiers	
Track record and investment performance	Neutral
Risk management	Neutral
Transparency and complexity	Neutral
Comparable rating analysis	Neutral
Stand-alone credit profile	bbb+
Group credit profile	BBB+

Related Criteria

- Criteria | Financial Institutions | Other: Alternative Investment Funds Methodology , Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021
- General Criteria: Group Rating Methodology , July 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Principles Of Credit Ratings , Feb. 16, 2011

Related Research

- 3i Group PLC, Dec. 16, 2022
- 3i Group PLC, Feb. 14, 2022
- 3i Group Upgraded To 'BBB+' On Robust Operating Performance; Outlook Stable, July 23, 2021

Ratings List

New Rating	
3i Group PLC	
Senior Unsecured	BBB+
Ratings Affirmed	
3i Group PLC	
Issuer Credit Rating	BBB+/Stable/A-2
3i Group PLC	
Senior Unsecured	BBB+